

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

RICHARD WOOL and ALLAN
MAYER, on behalf of the Sitrick and
Company Employee Stock Ownership
Plan,

Plaintiffs,

vs.

MICHAEL S. SITRICK and NANCY
SITRICK, husband and wife; THE
MICHAEL AND NANCY SITRICK
TRUST, a trust; RELIANCE TRUST
COMPANY, a Georgia corporation
SITRICK AND COMPANY, INC., a
California corporation;

Defendants,

SITRICK AND COMPANY
EMPLOYEE STOCK OWNERSHIP
PLAN;

Nominal Defendant.

Case No. 2:10-cv-02741-JHN-PJWx

**ORDER GRANTING IN PART AND
DENYING IN PART THE SITRICK
DEFENDANTS' MOTION TO
DISMISS**

Judge: Honorable Jacqueline H. Nguyen

The matter is before the Court on the Sitrick Defendants' Motion to Dismiss the Second Amended Complaint ("Motion") (docket no. 72), filed on October 18, 2010. The Court has considered the briefs filed in this matter, and deems the matter appropriate for decision without oral argument. *See* Fed. R. Civ. P. 78; Local Rule 7-15. Accordingly, the hearing set for December 6, 2010, is removed from the Court's calendar. For the reasons herein, the Court GRANTS

IN PART and DENIES IN PART the Motion.

I.

FACTUAL BACKGROUND

In 1989, Defendant Michael S. Sitrick (“Sitrick”) founded Sitrick and Company, Inc. (“SCI”), a company providing “strategic communication services” to various businesses, agencies, and individuals. (Second Am. Compl. (“SAC”) ¶¶ 3, 6, 12.) Sitrick was SCI’s sole shareholder. (*Id.* at ¶ 18.)

A. The Employee Stock Ownership Plan

On March 1, 1999, SCI established the Sitrick and Company Employee Stock Ownership Plan (“ESOP”) and the Employee Stock Ownership Trust. (SAC ¶ 17.) “The ESOP is a stock bonus plan qualified under § 401(a) of the Internal Revenue Code of 1986 as amended and is an employment stock ownership plan as defined under ERISA.” (*Id.*) SCI appointed Sitrick as the ESOP’s sole trustee and issued 1,702,400 shares of Class B stock to the Michael and Nancy Sitrick Trust (“Sitrick Trust”). (*Id.* at ¶ 19–21.) The Sitrick Trust sold all those shares of Class B stock to the ESOP for approximately \$15,321,600 or \$9.00 per share. (*Id.* at ¶ 22.) This transaction left the ESOP with 24.32% of the total equity in SCI, while Sitrick owned the remaining equity in SCI through his Class A shares. (*Id.*) SCI financed the stock purchase by borrowing the amount of the purchase price and loaning it to the ESOP. (*Id.* at ¶ 23.) “The ESOP paid the Sitrick Trust for the Class B shares and executed and delivered to SCI a promissory note payable in installments of principal and interest.” (*Id.*) Plaintiffs allege that “the total equity of the SCI exceeded the sum of \$60 million in or about March 1999.” (*Id.* at ¶ 25.)

From 2001 to 2008, SCI “continued to grow and prosper” with, for instance, over \$22.5 million in total revenues for the year ending December 31, 2008. (SAC ¶ 29.) However, “[d]espite the profitability and growth of the Company, as well as the reduction of the ESOP indebtedness each year, the ESOP

1 reported to its participants and beneficiaries a decline in the value of Plan assets
2 and share value virtually every year from 2001 to 2008.” (*Id.* at ¶ 31.) “As a
3 result, the gross value of Plan assets declined from a reported high of
4 approximately \$17.36 million in 2000, to a reported low of approximately \$1.7
5 million in 2008, despite the fact that the original ESOP indebtedness of
6 approximately \$15.3 million was almost fully repaid by December 31, 2008.” (*Id.*
7 at ¶ 32.)

8 Plaintiffs contend that this loss of nearly 90% of the ESOP’s original fair
9 market value resulted, in large part, from “self-dealing by Sitrick and [a] breach
10 of his fiduciary duties as trustee of the ESOP.” (SAC ¶ 33.) In particular, Plaintiff
11 contends the loss stemmed from payments to Sitrick beginning in or around 2005
12 and a “2008 Stock Repurchase Transaction.” (*Id.* ¶¶ 34–103.)

13 **B. Payments to Sitrick**

14 Plaintiffs allege that SCI made payments to Sitrick beginning in or around
15 2005 that the SAC describes as “Excessive Compensation payments,” “Personal
16 Expenditures,” and “Airplane Expenditures.” (SAC ¶¶ 34–68.)

17 According to the SAC, Sitrick himself determined the amount of
18 compensation he received from SCI. (SAC ¶ 37.) He received both an annual
19 salary of \$600,000 and other compensation. Before 2005, his other compensation
20 included an annual bonus of between \$500,000 and \$1 million (*Id.* at ¶ 36.)
21 Beginning in 2005, he received other compensation of greater than \$3 million per
22 year. (*Id.* at ¶ 40.) The SAC alleges that these latter payments were royalty
23 payments for SCI’s use of Sitrick’s personal goodwill and reputation, which he
24 believed was responsible for more than 90% of SCI’s business. (*Id.* at ¶¶ 35, 42.)
25 Sitrick’s other compensation in 2005 represented more than 44% of SCI’s
26 earnings before interest and taxes, and his other compensation in 2006–2008
27 represented more than 60% of the company’s earnings before interest and taxes.
28 According to the SAC, the Excessive Compensation payments “constitute

1 excessive and unreasonable compensation to Sitrick which he approved as a
2 director and ESOP Trustee while acting with a conflict of interest.” (*Id.* at ¶ 44.)

3 “Personal Expenditures” refers to payments SCI made for legal and other
4 expenses related to litigation involving Sitrick in his individual capacity or in his
5 capacity as trustee of the Sitrick Trust. (SAC ¶¶ 49–50.) “Airplane Expenditures”
6 refers to payments SCI made to purchase airplanes used mainly by Sitrick and his
7 family for personal use. (*Id.* at ¶ 56–64.) One airplane was purchased at a cost of
8 more than \$14 million, which represented almost 63% of SCI’s total revenues for
9 2008. (*Id.* at ¶¶ 60–63.)

10 For all three forms of payments to Sitrick, the SAC alleges that the
11 payments represented the payment of dividend income to Sitrick and that the
12 ESOP was entitled to receive a pro rata share as a minority shareholder in SCI.
13 (SAC ¶¶ 46, 52, 65.) Additionally, the SAC alleges that Sitrick breached his
14 fiduciary duty as a director of SCI by approving the Personal Expenditures and
15 Airplane Expenditures (*id.* at ¶¶ 53, 66), and that Sitrick, as an ESOP trustee (and,
16 for the Excessive Compensation payments, as an SCI director), though aware of
17 these payments to himself, did not object to the payments themselves or the
18 failure to pay the ESOP its pro rata share, and did not take legal action to recover
19 the losses to the ESOP. (*Id.* at ¶¶ 47, 54, 67.) All forms of payments to Sitrick
20 diluted the value of the ESOP’s ownership interest in SCI and led to ESOP
21 valuations below the market value for the shares it held. (*Id.* at ¶¶ 48, 55, 68.)

22 **C. The 2008 Stock Repurchase Transaction**

23 With respect to the 2008 Stock Repurchase Transaction (or “Repurchase
24 Transaction”), Sitrick allegedly learned of an offer from Resources Connection,
25 Inc. (“Resources”) to purchase SCI assets or stock for an amount in excess of \$70
26 million. (SAC ¶ 69.) Upon learning of this lucrative offer, Sitrick deferred the
27 offer in order to first buy the ESOP’s SCI shares, through the Repurchase
28 Transaction. (*Id.* at ¶¶ 70–71.) Sitrick “conceived the concept for the Repurchase

Transaction” and determined the price for the stock, in the range of \$2 million. (*Id.* at ¶¶ 71, 73.) Sitrick and Nancy Sitrick, as SCI directors, engaged an independent fiduciary, Reliance Trust Company (“Reliance”), as a special trustee for the ESOP to approve the transaction even though Sitrick and Nancy Sitrick “knew that the Repurchase Transaction was unfair to the ESOP, and that under the Repurchase Transaction, the ESOP would receive consideration worth far less than the value of its SCI stock.” (*Id.* at ¶¶ 75–76.)

Reliance engaged an appraiser that valued the ESOP shares at less than \$2 million. (*Id.* at ¶ 78.) The appraiser’s primary source of information was Sitrick and SCI’s chief financial officer. (*Id.* at ¶ 81.) Sitrick breached his duty as an ESOP trustee to provide Reliance with information relevant to the approval decision by failing to provide various items of information, including information about other companies’ interest in purchasing SCI; the course of negotiations with Resources; and the conflicted transactions involved in the Excessive Compensation payments, the Personal Expenditures, and the Airplane Expenditures; and the information that “no reasonably prudent and diligent ESOP fiduciary informed of all relevant facts and circumstances relating to SCI and its value would approve the proposed Repurchase Transaction for any purchase price in the range of \$2 million.” (*Id.* at ¶ 82.)

In terms of Reliance’s purported liability, the SAC claims that Reliance failed to conduct a “careful and prudent investigation” into the circumstances surrounding the Repurchase Transaction and “failed to determine in good faith the fair market value of the ESOP’s Class B shares.” (SAC ¶ 83.) Instead, “Reliance and its financial advisor assumed that the Excessive Compensation payments, the Personal Expenditures and the Airplane expenses were necessary and proper business expenses and/or contractual, valid, and binding.” (*Id.* at ¶ 85.) Reliance also failed to approve the use of a minority interest value to determine the fair market value of the ESOP’s shares. (*Id.* at ¶ 87.) As a result,

1 Reliance and its advisor determined that about \$1.7 million was a fair price for
 2 the ESOP shares for purposes of the Repurchase Transaction. (*Id.* at ¶ 88.) Given
 3 the ESOP’s share of SCI stock, this implied a total value of \$7.23 million for the
 4 company, a reduction of about 90% of value from 1999 to 2008, “despite the fact
 5 that Sitrick had received offers to purchase SCI in excess of \$60 million from in
 6 or about 2000 through 2008.” (*Id.* at ¶¶ 89–90.)

7 As a result of the Repurchase Transaction, Plaintiffs allege that the
 8 valuation of the ESOP’s Class B shares was “a colossal understatement” of their
 9 fair market value and that the ESOP received “far less than adequate
 10 consideration in this prohibited transaction between the ESOP and parties in
 11 interest.” (SAC ¶¶ 91–92.)

12 II.

13 PROCEDURAL HISTORY

14 On April 15, 2010, Plaintiffs Richard Wool and Allan Mayer (collectively
 15 “Plaintiffs”) filed this lawsuit on behalf of the ESOP. Plaintiffs filed their FAC on
 16 May 15, 2010, against Defendants Sitrick, Nancy Sitrick, and the Sitrick Trust
 17 (the “Sitrick Defendants” or “Defendants”), and Defendant Reliance and Nominal
 18 Defendants SCI and the ESOP. On August 10, 2010, the Court issued an order
 19 (the “August 10 Order”; docket no. 49) granting in part motions to dismiss by the
 20 Sitrick Defendants and Reliance. Plaintiffs filed the SAC on September 13, 2010,
 21 naming the same defendants but changing SCI’s status from that of a nominal
 22 defendant to a defendant. Plaintiffs assert the following causes of action under the
 23 Employee Retirement Income Security Act of 1974 (“ERISA”), 29 U.S.C. § 1001
 24 *et seq.*:

- 25 (1) Violation of Section 404 of ERISA, 29 U.S.C. § 1104, against
 26 Sitrick and Nancy Sitrick;
- 27 (2) Violation of Section 404 of ERISA, 29 U.S.C. § 1104, against
 28 Sitrick for failing to provide material information to Reliance;

- 1 (3) Violation of Section 404 of ERISA, 29 U.S.C. § 1104, against
- 2 Reliance;
- 3 (4) Violation of Sections 406 and 408 of ERISA, 29 U.S.C. §§ 1106 and
- 4 1108, against Sitrick, Nancy Sitrick, the Sitrick Trust, Reliance, and
- 5 SCI;
- 6 (5) Violation of Section 405 of ERISA, 29 U.S.C. § 1105, against
- 7 Sitrick and Reliance; and
- 8 (6) Equitable remedies under Sections 409(a) and 501(a)(3) of ERISA,
- 9 29 U.S.C. §§ 1109(a) and 1132(a)(3), against the Sitrick Trust.

10 On October 18, 2010, the Sitrick Defendants filed the instant Motion.

11 Plaintiffs subsequently filed an Opposition, and the Sitrick Defendants thereafter

12 filed a Reply.

13 **III.**

14 **LEGAL STANDARD**

15 Rule 12(b)(6) permits a defendant to seek dismissal of a complaint that

16 “fail[s] to state a claim upon which relief can be granted.” Fed. R. Civ. P.

17 12(b)(6). In evaluating a motion to dismiss, the Court generally cannot consider

18 material outside the complaint, such as facts presented in briefs, affidavits, or

19 discovery materials, unless such material is alleged in the complaint or judicially

20 noticed. *McCalip v. De Legarret*, No. CV 08-2250 CAS (FFMx), 2008 U.S. Dist.

21 LEXIS 87870, at *4 (C.D. Cal. Aug. 18, 2008); *see Jacobson v. AEG Capital*

22 *Corp.*, 50 F.3d 1493, 1496 (9th Cir. 1995). The Court must accept as true all

23 material factual allegations in the complaint and construe them in the light most

24 favorable to the plaintiff. *Nursing Home Pension Fund, Local 144 v. Oracle*

25 *Corp.*, 380 F.3d 1226, 1229 (9th Cir. 2004). However, this tenet is inapplicable to

26 legal conclusions. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009). The Court

27 need not accept as true “[t]hreadbare recitals of the elements of a cause of action,

28 supported by mere conclusory statements.” *Id.* The Court, based on judicial

1 experience and common sense, must determine whether a complaint plausibly
2 states a claim for relief. *Id.* at 1950.

3 Part of the Court's determination as to whether a claim plausibly states a
4 claim for relief involves an analysis of a pleading's factual specificity. Asserting
5 more than mere conclusory statements, a complaint must provide a factual basis
6 showing that a plaintiff is entitled to relief and to give the defendant fair notice of
7 claims and relief asserted. *Id.* at 1950–51; *Bell Atl. Corp. v. Twombly*, 550 U.S.
8 544, 556 (2007); Fed. R. Civ. P. 8(a)(2). Although a lengthy factual background
9 is unnecessary, dismissal of a complaint is warranted where the plaintiff fails to
10 allege specific facts needed to support the plausibility of a claim or provide fair
11 notice to the opposing party. *See id.*

12 Dismissal is also warranted where a complaint alleging fraud fails to meet
13 the heightened pleading standards of Federal Rule of Civil Procedure 9(b).
14 Although “[m]alice, intent, knowledge, and other conditions of a person’s mind
15 may be alleged generally,” a complaint “must state with particularity the
16 circumstances constituting fraud or mistake.” Fed. R. Civ. P. 9(b). “Averments of
17 fraud must be accompanied by ‘the who, what, when, where, and how’ of the
18 misconduct charged.” *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1106 (9th
19 Cir. 2003) (citation omitted). This includes allegations as to the particular
20 statement and why it was false or misleading. *Id.* Failure to sufficiently allege
21 fraud claims mandates their dismissal. *Id.* Failure to sufficiently allege fraud as
22 part of a claim of which fraud is not a necessary element requires that the court
23 determine whether, disregarding the allegations of fraud, the complaint
24 sufficiently states a claim under the Rule 12(b) standard. *Id.* at 1104–05.

25 If a complaint is dismissed, leave to amend is liberally granted. Fed. R. Civ.
26 P. 15(a); *Morongo Band of Mission Indians v. Rose*, 893 F.2d 1074, 1079 (9th
27 Cir. 1990). However, it is proper to deny leave to amend if the amendment would
28 be futile or the complaint has previously been amended. *AmerisourceBergen*

1 *Corp. v. Dialysist West, Inc.*, 465 F.3d 946, 951 (9th Cir. 2006); *Ascon Props.*,
 2 *Inc. v. Mobil Oil Co.*, 866 F.2d 1149, 1160 (9th Cir. 1989).

3 IV.

4 DISCUSSION

5 Defendants' Motion seeks dismissal of Counts I, II, and V of the SAC on
 6 various grounds. For the reasons set forth below, the Court dismisses Count I in
 7 part, strikes Count II, and dismisses Count V as alleged against Sitrick.

8 A. Count I

9 Plaintiffs assert Count I—for violation of section 404 of ERISA, 29 U.S.C.
 10 § 1104—against Sitrick and Nancy Sitrick. Section 404 imposes many duties on
 11 ERISA fiduciaries, including the obligation to discharge one's duties "with
 12 respect to a plan solely in the interest of the participants and beneficiaries" and
 13 "with the care, skill, prudence, and diligence under the circumstances then
 14 prevailing that a prudent man acting in a like capacity and familiar with such
 15 matters would use in the conduct of an enterprise of a like character and with like
 16 aims." 29 U.S.C. § 1104(a).

17 1. Preemption of Claim Based on SCI's Payments to Sitrick

18 The Court previously held that a claim under a separate ERISA provision,
 19 section 406, 29 U.S.C. § 1106, prohibiting certain transactions between a plan and
 20 a fiduciary or party in interest, could not be maintained on the basis of the royalty
 21 payments to Sitrick, because those payments were made by SCI rather than by the
 22 ESOP. (Aug. 10 Order 14–15.) On the basis of that holding, Defendants seek
 23 dismissal of Count I in that it is based on payments by SCI for the Excessive
 24 Compensation payments, the Personal Expenditures, and the Airplane
 25 Expenditures.

26 Plaintiffs assert that the SAC brings this claim based on a new theory and
 27 new allegations. The SAC alleges that Sitrick and Nancy Sitrick breached
 28 fiduciary duties imposed on them as directors—and for Sitrick, as an officer—of

1 SCI. (SAC ¶ 108.) This breach consisted of Sitrick and Nancy Sitrick's approval
2 of—and for Sitrick, benefiting from—the Excessive Compensation Payments, the
3 Personal Expenditures, and the Airplane Expenditures. (*Id.*) The SAC further
4 alleges that Sitrick, as an ESOP trustee, had a duty to bring a state law derivative
5 action on behalf of the ESOP as a shareholder of SCI, to recover the ESOP's pro
6 rata share of dividend income represented by those payments to Sitrick. (*Id.* at ¶¶
7 109–110.) Because Sitrick, as an ESOP trustee, failed to bring that state law
8 shareholder's derivative action, Sitrick breached his duty as an ERISA fiduciary
9 under section 404. (*Id.*)

10 Defendants counter that the SAC still fails to state a claim, even under this
11 new theory, because the applicable shareholder's derivative action would be
12 preempted by ERISA. Defendants argue both express preemption and conflict
13 preemption.¹ (Mot. 7–13.)

14 Conflict preemption applies where a state law creates an obstacle to
15 achieving Congress's purpose in enacting a federal law. *Gade v. Nat'l Solid*
16 *Wastes Mgmt. Ass'n*, 505 U.S. 88, 98 (1992). The Supreme Court has found
17 conflict preemption applicable to state laws conflicting with ERISA's goals. For
18 example, “any state-law cause of action that duplicates, supplements, or supplants
19 the ERISA civil enforcement remedy conflicts with the clear congressional intent
20 to make the ERISA remedy exclusive and is therefore pre-empted.” *Aetna Health*
21 *Inc. v. Davila*, 542 U.S. 200, 209 (2004).

22 The Court has already held that a claim based on expenditures of non-plan
23 assets is not actionable under ERISA section 406, the provision barring interested
24 transactions. (Aug. 10 Order, 14–15.) As the Ninth Circuit explained in *Johnson*
25 *v. Couturier*, 572 F.3d 1067 (9th Cir. 2009), allowing recovery under ERISA for
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27 ¹ Because the Court agrees with Defendants' conflict preemption argument, it
28 does not reach the issue of express preemption.

1 business decisions such as corporate salaries would extend the reach of ERISA
2 far beyond its intended purview. *Id.* at 1077. ERISA fiduciary duties are properly
3 circumscribed to apply to transactions involving *plan* assets.² *Id.* Plaintiffs' theory
4 would extend ERISA liability precisely into an area outside its purview. Thus,
5 allowing Plaintiffs' claim to go forward would "supplement" ERISA in a way
6 that clearly conflicts with congressional intent. Accordingly, the Court finds the
7 claim based on Plaintiffs' theory of a duty to bring a shareholder's derivative
8 action preempted. Count I is dismissed to the extent its allegations support that
9 theory.

10 2. Claims Based on a Duty to Monitor and Inform Reliance

11 The SAC presents another new theory for the imposition of ERISA
12 fiduciary duties on the Sitricks: that they failed to monitor or fully inform
13 Reliance of facts necessary to its evaluation of the Repurchase Transaction. (SAC
14 ¶¶ 115–116.)

15 ERISA defines a fiduciary as an individual who "exercises any
16 discretionary control respecting management or [an ERISA] plan or exercises any
17 authority or control respecting management or disposition of its assets." 29
18 U.S.C. § 1002(21)(A)(i). "Where members of an employer's board of directors
19 have responsibility for the appointment and removal of ERISA trustees, those
20 directors are themselves subject to ERISA fiduciary duties, albeit only with
21 respect to trustee selection and retention." *Johnson*, 572 F.3d at 1076; *see also*
22 *Batchelor v. Oak Hill Med. Group*, 870 F.2d 1446, 1449 (9th Cir. 1989). These
23 Ninth Circuit cases rely on a Department of Labor interpretive bulletin that also
24 provides that "[a]t reasonable intervals the performance of trustees and other
25 fiduciaries should be reviewed by the appointing fiduciary in such manner as may
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27 ² Johnson found plan assets implicated on the facts of that case; as the Court
28 previously concluded, similar facts do not exist here. (Aug. 10 Order 15.)

1 be reasonably expected to ensure that their performance has been in compliance
2 with the terms of the plan and statutory standards.” 29 C.F.R. § 2509.75-8 (FR-
3 17).

4 On the basis of this authority, the Court agrees that a duty to monitor an
5 appointed fiduciary exists.³

6 Defendants argue that even if such a duty exists, it should not apply under
7 the facts of this case. (Reply 10.) Here, they argue, the Sitricks appointed
8 Reliance to determine the propriety of the Repurchase Transaction because of the
9 Sitricks’ conflict of interest with respect to the transaction; imposing a duty on the
10 Sitricks to monitor Reliance would implicate that conflict of interest. (*Id.*) The
11 Court agrees that this set of facts is particularly problematic. However, it does not
12 agree that the Sitricks were relieved of ERISA fiduciary duties because they were
13 interested parties in the transaction. Rather than being relieved of duties, an
14 interested party in particular must be subject to ERISA’s requirements. “Although
15 the scope of the duty to monitor is often unclear, many courts have declined to
16 dismiss a duty to monitor claim on a motion to dismiss.” *In re Syncor ERISA*
17 *Litig.*, 351 F. Supp. 2d 970, 986 (C.D. Cal. 2004). The Court agrees with the
18 wisdom of this approach and declines to dismiss Count I to the extent that it is
19 premised on a duty to monitor Reliance.

20 An appointing fiduciary’s duties with respect to the appointed fiduciary
21 also logically includes a duty to fully inform the appointed fiduciary so that it
22 may meet its responsibilities under ERISA. *See id.* (“Courts have repeatedly
23 acknowledged that a board of directors may have a duty to monitor investments,
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25 ³ The Court also finds persuasive the out-of-circuit authority to which Plaintiffs
26 cite in their Opposition and finds the approach of the district court cases cited in
27 Defendants’ Motion needlessly restrictive. The discretionary control over the retention
28 of an appointed fiduciary implies the duty to affirm that the fiduciary should be
retained; the mechanism for meeting this duty is to monitor the appointed fiduciary.

1 and that the duty sometimes includes a duty to disclose information to committee
2 members.”). Plaintiffs have sufficiently alleged a failure to inform Reliance of
3 other companies’ interest in purchasing SCI, the course of negotiations with
4 Resources, and the conflicted transactions involved in the payments to Sitrick.
5 (SAC ¶ 82.) Each of these allegations is supported by further factual detail in the
6 SAC. (*Id.* at ¶¶ 34–68, 101–102.) This is material information with respect to
7 Reliance’s evaluation of the value of the ESOP’s shares and the fairness of the
8 Repurchase Transaction. Accordingly, the Court declines also to dismiss Count I
9 to the extent that it is premised on a failure to inform Reliance.⁴

10 In sum, the Court dismisses Count I to the extent it is based on breaches
11 related to the payments to Sitrick but declines to dismiss Count I to the extent it is
12 based on breaches related to Reliance’s appointment and retention. Because
13 Plaintiffs have previously been given leave to amend and because the Court finds
14 the dismissed portions of Count I to be preempted as a matter of law, the
15 dismissal is *with prejudice*. See *Ascon Props.*, 866 F.2d at 1160.

16 **B. Count II**

17 Plaintiffs assert Count II—also for violation of section 404 of ERISA, 29
18 U.S.C. § 1104—against Sitrick. Defendants focus on the Court’s previous order,
19 which determined that the allegations related to Sitrick’s failure to inform
20 Reliance did not meet the heightened pleading standard of Rule 9(b). (Mot.

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22
23 ⁴ The Court acknowledges Defendants’ final argument in their Motion and
24 Reply, which is based on their claim that evidence exists showing Sitrick informed
25 Reliance of the negotiations with Resources. (Mot. 20–21; Reply 19.) However, on
26 a motion to dismiss, the Court must base its decision on the allegations in the
27 complaint and cannot here consider the additional information submitted with
28 Defendants’ Reply. (Reply Ex. A.) The Court assumes that Plaintiffs are aware of their
Rule 11 obligations and that if Plaintiffs reach the conclusion that their allegations are
without a factual basis, Plaintiffs will seek leave to amend rather than be subject to
sanctions.

1 16–18.) In that order, the Court observed that “Plaintiffs’ claims against Sitrick
2 are grounded in fraud. For instance, with regard to the Stock Repurchase,
3 Plaintiffs allege that Sitrick ‘conceived [a] plan’ to repurchase the ESOP stock for
4 his personal financial gain and ‘carr[ied] out his plan’ by ‘caus[ing]’ SCI to hire
5 Reliance.” (Aug. 10 Order 12.)

6 Defendants argue that the allegations in the SAC are still grounded in
7 fraud. The Court disagrees. First, the specific language to which the Court
8 previously pointed has been changed or excised in the SAC. Moreover, the
9 allegations in the SAC to which Defendants point do not necessarily support a
10 theory of a fraudulent course of conduct. Plaintiffs allege that Sitrick “conceived
11 the concept” to purchase the ESOP’s stock for less than \$2 million (SAC ¶¶ 71,
12 73), that he engaged Reliance “in an effort to gain approval of the proposed
13 Repurchase Transaction even though he knew that the Repurchase Transaction
14 was unfair to the ESOP” (*id.* at ¶ 75), that he engaged Reliance “for the sole
15 purpose of effectuating the Repurchase Transaction” (*id.* at ¶ 112), and that he
16 “controlled the information flow to the appraisers and Reliance.” (*Id.* at ¶ 111.)
17 Though the Court agrees that such allegations could support a claim for fraud, the
18 SAC does not allege an intent to defraud. These allegations as plausibly go to an
19 intent to manipulate, which is distinguishable. The Court therefore declines to
20 find that the SAC alleges a fraudulent course of conduct and reads the SAC
21 accordingly—that is, the Court finds that the SAC alleges an intentional breach of
22 Sitrick’s fiduciary duty, for which ERISA may provide relief.⁵

23 However, the Court finds Count II problematic for a separate reason not
24 identified by Defendants: it is entirely duplicative of the allegations in Count I
25 that Sitrick breached his fiduciary duty by failing to inform Reliance of the

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27 ⁵ The Court notes that because it reads the SAC as not containing allegations
28 of fraud, the forms of relief attendant on a finding of fraud are not available to
Plaintiffs.

1 material information necessary to its evaluation of the Repurchase Transaction.
2 For example, in the discussion above regarding Count I, the Court identified
3 paragraph 82 of the SAC as providing factual allegations that Sitrick failed to
4 inform Reliance. This paragraph supports the allegation in Count I that Sitrick
5 breached his fiduciary duties to the ESOP by “failing to ensure that Reliance was
6 fully informed of all relevant facts and circumstances in determining the fairness
7 of the Repurchase Transaction.” (SAC ¶ 115(G).) The allegations in paragraph 82
8 are repeated verbatim in paragraph 123, under Count II. Accordingly, the Court
9 strikes Count II as duplicative of Count I. *See Atlantic Richfield Co. v. Ramirez*,
10 No. 98-56372, 1999 WL 273241, at *2 (9th Cir. May 4, 1999); *Wilkerson v.*
11 *Butler*, 229 F.R.D. 166, 170 (E.D. Cal. 2005).

12 **C. Count V**

13 Plaintiffs assert Count V—for violation of section 405 of ERISA, 29
14 U.S.C. § 1105, against Sitrick and Reliance. Section 405 imposes liability on a
15 fiduciary for another fiduciary’s breach if the fiduciary knows of the breach by
16 the other fiduciary and either knowingly participates in the breach or conceals it,
17 or does not make reasonable efforts to remedy the breach. 29 U.S.C. § 1105(a)(1),
18 (3).

19 The Court’s prior order concluded that Count V—Count III of the First
20 Amended Complaint—“failed to allege a sufficient factual basis to support the
21 scienter requirement” in the ERISA provision. (Aug. 10 Order 18.)

22 Plaintiffs assert that the SAC includes “detailed allegations about Sitrick’s
23 ‘actual knowledge’ of Reliance’s breaches,” and point to paragraphs 150–152.
24 (Opp’n 25.) Paragraph 150 lays out several items of information that Sitrick
25 allegedly knew. However, none of these items of information refers to Reliance.
26 Paragraph 151 alleges that Sitrick knew Reliance had not asserted the ESOP’s
27 claim against Sitrick or SCI. This is sufficient to allege knowledge of a breach by
28 Reliance. However, there are not sufficient factual allegations that establish

1 Sitrick's knowing participation in or concealment of that breach, or Sitrick's
2 failure to take reasonable efforts to remedy the breach. Paragraph 152 makes
3 these legal allegations in conclusory fashion but does not support them with a
4 plausible factual basis.

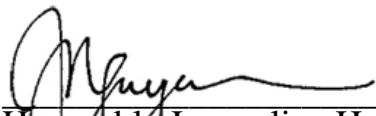
5 Accordingly, the Court dismisses Count V as to Sitrick. Because Plaintiffs
6 have previously been given leave to amend this count, the dismissal is *with*
7 *prejudice*. See *Ascon Props.*, 866 F.2d at 1160.

8 V.

9 CONCLUSION

10 For these reasons, the Court GRANTS IN PART and DENIES IN PART
11 the Sitrick Defendants' Motion (docket no. 72). The Court GRANTS the Motion
12 and dismisses *with prejudice* Count I (with respect to the payments to Sitrick
13 only) and Count V as alleged against Sitrick. The Court also STRIKES Count II.
14 The Court DENIES the Motion otherwise.
15 IT IS SO ORDERED.

16
17 Dated: November 30, 2010

18 
19 Honorable Jacqueline H. Nguyen
20 UNITED STATES DISTRICT COURT
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